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SUBJECT: NEW CEO ON CHANGE IN KESC LEADERSHIP AND FUTURE OF  
KARACHI'S POWER SYSTEM

REF: A. ISLAMABAD 2022  
B. ISLAMABAD 1724

¶1. (U) This is a joint Consulate General Karachi-Embassy  
Islamabad message.

¶2. (SBU) Summary: Karachi Electric Supply Company (KESC) CEO Tabish Gahaur said that KESC had made significant strides in increasing collections and bringing new generation on line since Abraaj Capital took over its management in September 2008. However, Gahaur was installed in place of former CEO Naveed Ismail on November 2 in order to manage and reform KESC's human resources, improve power distribution, reduce distribution losses, and further increase collections. Gahaur said Abraaj already pumped \$193 million into KESC as part of its \$361 million purchase; between debt and equity, Abraaj would bring over \$1 billion to KESC for capital improvements. Though generation, distribution, and collection improvements were necessary to turn KESC around, Gahaur added that the long-term viability of KESC also depended on the increase in tariff rates and the payment of GOP arrears to the utility. End Summary.

New Leadership at KESC

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¶3. (SBU) Tabish Gahaur replaced Naveed Ismail as CEO of the Karachi Electric Supply Company (KESC) on November 2, with Ismail remaining on the KESC board and put in a new position with KESC's holding company in Islamabad. In a meeting with Assistance Coordinator, Acting USAID EG Director and Econoff, Abraaj Managing Director Mustafa Abdel-Wadood explained that, though former CEO Ismail had brought 405 MW of new generation on line under his tenure and increased collections, he did not have the necessary skill set to put in motion the next phase of Abraaj's plans for KESC: improving distribution, reducing losses, further increasing collections, and managing and trimming KESC's bloated 18,000 employee work force. He added that Gahaur was the prime mover behind Abraaj's original acquisition of KESC and therefore knew more about the company and Pakistan's energy sector players than Ismail. Gahaur has over 10 years experience in the energy sector with Exxon, HUBCO, and AES.

## Why Abraaj Purchased KESC

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**¶14.** (SBU) As reported reftels, KESC is a vertically integrated utility with generation, transmission and distribution assets serving 18 million consumers in Karachi and its environs. Decades of under-investment, poor maintenance, and mounting demand have contributed to chronic blackouts. KESC and Abraaj have been vociferously criticized by the media for their poor performance, with some calling for the utility to be re-nationalized. When Abraaj took over its management, KESC had operating losses of \$27 million each month.

**¶15.** (SBU) Abdel-Wadood said Abraaj was attracted to KESC because it was performing so poorly. For example, KESC had 40 percent losses in its distribution system when Abraaj took control, and every one percent improvement in distribution translates into \$12 million in increased revenue. To date, KESC has reduced losses to 35 percent, realizing \$60 million in revenue. He said Abraaj will profit by turning the company around, breaking off its more valuable generation assets from its distribution components, and selling it off to long term investors.

## Abraaj's Plans for KESC

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**¶16.** (SBU) New KESC CEO Gahaur said that Abraaj had already invested \$193 million in KESC, putting it ahead of schedule

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in its purchase agreement to invest \$361 million over three years (ref A). Under the same agreement, the GOP has injected \$45 million and agreed to provide an additional \$95 million. Gahaur plans to leverage the Abraaj and GOP capital contributions with debt to raise over \$1 billion for capital improvements. He said that with these investments, Abraaj could turn KESC around in three to five years.

**¶17.** (SBU) Gahaur said KESC had already increased its generation capacity by 405 MW through the construction of new plants and the rehabilitation of older facilities, with an additional 50 MW due to come on line by December 2009. He said between its own generation and power purchases from the GOP and independent power producers (IPPS), KESC has 2579 MW in capacity supply. (Note: This is still roughly 1000 MW short of peak demand. End note.) He added that KESC had finalized financing with the International Finance Corporation (IFC) and the Asian Development Bank (ADB) to build a 560 MW gas-fired plant to be completed by 2013.

**¶18.** (SBU) Gahaur said that the next management challenge was to improve KESC's human resource management. He noted that KESC's work force jumped from 8,000 to 18,000 between 2003 and 2008, as employees were added to the company payroll prior to privatization. While nothing in the implementation agreement prevents KESC from right-sizing, Gahaur said it is "difficult in this political environment." Instead, KESC plans to slowly right-size through retraining and dedicating some employees to corporate social responsibility activities.

According to Gahaur, payroll costs are not the main problem with the thousands of extra employees. He said the effect on culture and productivity is the larger issue. To combat the negative effects, he plans to put several thousand "trouble-making" employees into placeholder jobs where they would essentially do nothing. He said KESC was working on CBA's with the five employee unions, which are all "connected to political parties." He planned to lobby the GOP to declare KESC an "essential service" which would curtail the unions' ability to strike.

**¶19.** (SBU) Gahaur said KESC would also focus on improving the distribution network, through investments in infrastructure and human resource improvements. He said lower technical losses and improved collections had already more than halved

monthly operating losses from \$27 million to \$12 million. Abdel-Wadood noted improvements to the antiquated grid would reduce blackouts and improve KESC's public image.

¶10. (SBU) This week, KESC worked to resolve the outstanding debts with Karachi's largest IPPs, Gul Ahmed Energy and Tapal, to whom it owes \$75 million. KESC reached an agreement with Tapal in which it paid \$5.6 million and agreed to a payment schedule that will reduce the entire debt over the next several years. The same deal was offered to Gul Ahmed, and KESC hopes to have an answer soon.

#### Potential Hurdles with the GOP

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¶11. (SBU) Gahaur said KESC had positive working relationships with the Ministries of Finance, Water and Power, Petroleum and Natural Resources, as well as NEPRA, the power sector regulator. He added that PEPCO -- Pakistan's holding company for public sector distribution and generation companies -- had also been cooperative, though he opined "it might not be in their interest to see us succeed as a private company."

¶12. (SBU) Gahaur said the GOP owes KESC \$217 million in unpaid subsidies and \$265 in unpaid power bills from public sector entities. In turn, KESC owes \$373 million to both private and GOP-owned power and fuel suppliers. He said Finance Minister Shaukat Tarin agreed to pay these arrears but has yet to do so. KESC CFO Zulfiqar Ali said that

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current tariff rates also undermine KESC's financial viability. He noted that the NEPRA-set tariffs did not adjust enough to cover rising fuel and thermal generation costs. Moreover, he said the tariff should be adjusted upwards to reflect KESC's poor collection rate, allowing that it could be adjusted down over subsequent years as collection rates improved. Abdul-Wadood said these "sovereign issues" were the one area that made Abraaj hesitate before investing in KESC, and the long-term viability of the firm depends on their resolution.

#### Winter Forecast

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¶13. (SBU) Demand is already reduced from the summer highs, but Karachi still faces three hours of load shedding per day. Although peak demand will drop to 1600-1700 MW, KESC's supply diminishes as well. PEPCO normally sells 650MW to KESC, but given reduced hydropower production during the winter, KESC was informed that for at least 30 days in December and January, they will receive no more than 350MW. (Note: KESC is supposed to phase out, over five years, receiving power from PEPCO. End note.) The supply of natural gas received currently is only 180 million cubic feet per day, but a minimum of 225 is required. Additionally, KESC is, with GOP help, working to broker a deal with Pakistan State Oil (PSO) that will enable KESC to purchase furnace oil on 45-90 day credit. Gahaur stated that if a minimum of 225 million cubic feet per day of natural gas and 350 MW of power from PEPCO were supplied, and a deal reached with PSO, then KESC will be "ok" for the winter. Otherwise, the "winter will be tough" with increased blackouts.

¶14. (SBU) The final variable in KESC's equation is the strength of industry. Load shedding and the supply-demand gap were reduced because of lower demand from the economic slowdown. When industry begins to recover, their demand for power increases and everyone, including private households, will face increased power outages. (Note: As a policy, KESC tries to avoid load shedding to industry due to the economic impact and because industry pays its bills. End note.)

¶15. (SBU) Comment: Gahaur and Abdul-Wadood made a compelling case that they are taking the much needed steps (including a

change in management) to turn KESC around. Even in the best case scenario, however, change will not be instant. Under former CEO Ismail's tenure, KESC was pilloried in the press and on the streets for its inability to provide power, especially during the peak summer months when there were daily blackouts of up to 18 hours in some areas. Gahaur and Abdel-Wadood will have an uphill battle if they are to avoid the same fate. We agree with Gahaur and Abdul-Wadood that until the GOP clears energy sector arrears and sets tariff rates that adequately recover costs, KESC and others in the energy sector will never have the financial wherewithal to fully rebound.

PATTERSON